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May 31, 1996

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

ORIGINAL

DOCKET FILE COPY ORIGINAL

Re: Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket 96-112

Dear Mr. Caton:

Enclosed herewith for filing are the original and eleven (11) copies of MCI Telecommunications Corporation's Comments regarding the above-captioned matter. Pursuant to the Commission's request, MCI is also submitting by separate cover a 3.5 inch diskette using MS DOS 5.0 and WordPerfect 5.1 software, containing our enclosed comments.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI Comments furnished for such purpose and remit same to the bearer.

Sincerely yours,

Lawrence Fenster

Lawrence Fenster

cc: Ernestine Creech
Accounting and Audits Division
Room 814
2000 L St., N.W.

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:	)	
	)	
Allocation of Costs Associated with	)	**CC Docket No. 96-112**
Local Exchange Carrier Provision of	)	
Video Programming Services	)	

COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

Lawrence Fenster
MCI Telecommunications Corp.
1801 Pennsylvania Ave., NW
Washington, DC 20006

May 31, 1996

Summary

The Telecommunications Act of 1996 permits incumbent local exchange companies (ILECs) to provide video programming services over their telephone networks by means of an open video system (OVS) under new Section 653 of the Communications Act. Now that ILEC video programming services may not be subject to regulation as common carrier services under Title II of the Communications Act, the Commission is required to reform Part 64 of its rules in order to protect telephone ratepayers from subsidizing ILEC entry into video and ultimately other nonregulated markets; and to ensure an fair and effective competition in the market for video and other nonregulated services.

MCI contends that direct assignment will not yield an equitable allocation of loop and other common costs among regulated and nonregulated purposes now as an ever-increasing amount of facilities are used in common by regulated and nonregulated activities. Consequently, the Commission must adopt an allocation method that will remove nonregulated costs from regulated activities. MCI recommends the Commission adopt allocations based on a stand alone cost ceiling because: (1) it would be administratively simple; (2) it would not require the Commission to establish specific cost pools; (3) it would not require ILECs to submit detailed cost studies; (4) it would establish consistency between "top down" allocated ILEC costs, and "bottoms up" incremental costs; and (5) it would obviate the need to measure spare capacity and develop mechanisms to remove it from regulated accounts.

There is a clear public interest reason for the Commission to adopt MCI's proposed allocation method. Unless the Commission removes nonregulated costs from regulated accounts,

telephone ratepayers will be forced to subsidize ILEC ventures into an ever-increasing array new, nonregulated lines of business. In the case of interexchange carriers, they would be forced to continue subsidizing ILEC entry into their own businesses. The Commission also runs a risk of over-promoting the entry of ILECs into the video business if it permits ILECs to move ahead with OVS applications in the absence of immediate Part 64 reform; or it runs the risk of delaying legitimate ILEC provision of OVS services if it engages in a series of rulemakings designed to establish complicated cost allocation mechanisms.

Before the
FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of:	)	
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Allocation of Costs Associated with	)	**CC Docket No. 96-112**
Local Exchange Carrier Provision of	)	
Video Programming Services	)	

I. Introduction

MCI Telecommunications Corporation ("MCI") respectfully submits its comments in response to the Notice of Proposed Rulemaking ("Notice") in the above-captioned docket[1]. In this Notice, the Commission is seeking comments from interested parties on its Part 64 rules to allocate costs between regulated and nonregulated activities, and is proposing modifications to those rules to protect telephone ratepayers from cost shifting now that incumbent local exchange carriers (ILECs) can offer video programming services on their networks.[2]

II. Background

MCI has long been concerned that the Commission's accounting, allocation, separations, and tariffing procedures contained in Parts 32, 36, 64, 61, and 69 of its rules were not designed to protect telephone customers from subsidizing the tremendous costs of ILEC entry into the

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1 In the Matter of Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket 96-112, FCC No. 96-214, released May 10, 1996.

2 Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56. In these comments, MCI refers to the new statute as either "the 1996 Act" or "the Act."

multichannel video distribution and programming market, as well as into a host of additional services. As a result, MCI has consistently advocated revising the Commission's rules to account for the new network architectures that were being built to integrate video services into the existing telephone network[3]

Prior to the passage of the Telecommunications Act of 1996, the Commission recognized that while ILECs' Section 214 applications were not clearly unlawful, their applications raised many concerns regarding their allocation of costs and subsequent tariffs. For example, in the case of Bell Atlantic's video dialtone rates in Dover Township, the Commission concluded that Bell Atlantic's tariff raised sufficient questions of lawfulness with respect to its cost allocation methods, rate levels, and various terms and conditions, that it warranted suspension and investigation.[4]

Congress has now determined that ILECs may provide video programming services over their telephone networks by means of an open video system (OVS) under new Section 653 of the Communications Act. Since ILEC video programming services provided under Section 653 will not be subject to regulation as common carrier services under Title II of the Communications Act,

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[3] See the following MCI Comments: In the Matter of Bell Atlantic Telephone Companies Rates, Terms, and Regulations for Video Dialtone Service in Dover Township, New Jersey, Transmittal Nos. 741, 786, Revision to Tariff F.C.C. No. 10, CC Docket No. 95-145, November 30, 1996; In the Matter of Telephone Company-Cable Television Cross Ownership Rules, Sections 63.54-63.58, CC Docket No. 87-266, March 32, 1995; In the Matter of the Southern New England Telephone Company Waiver of Section 69.106 of the Commission's Rules to Offer a Video Dialtone Trial and the Southern New England Telephone Company Tariff F.C.C. No. 40, Transmittal No. 641, March 29, 1995.

[4] In the Matter of Bell Atlantic Telephone Companies Revisions to Tariff FCC No. 10, Rates, Terms, and Regulations for Video Dialtone service in Dover Township, New Jersey, Transmittal Nos. 741, 786, CC Docket No. 95-145.

reform of Part 64 of the Commission's rules is required to resolve the cost allocation problems identified by the Commission in CC Docket 94-145 [5]

III. Goals and Purposes of This Rulemaking

In its Notice, the Commission requests parties to comment on goals it believes should guide its resolution of issues: (1) give effect to Congressional intent to create a competitive video marketplace; (2) implement the statutory language allowing ILECs to offer video services and programming; and (3) ensure ratepayers pay telephone rates that are just and reasonable.[6] The Commission recognizes that to achieve these objectives it must balance a number of factors: (1) administrative simplicity; (2) adaptability to evolving technologies; (3) uniform application among ILEC carriers; and (4) consistency with economic principles of cost-causation.[7]

MCI endorses the Commission's goals for this proceeding, and in particular, its recognition that ILEC entry into video distribution and programming should not come at the expense of telephone ratepayers. The Commission has begun an exploration of most of the cost allocation problems of ILEC provision of video services, as well as the cost impact of those problems on telephone customers, in its various proceedings implementing its Video Dialtone concept. MCI argues that the Commission should implement a simple rule that insulates

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[5] MCI continues to advocate that the Commission initiate rulemakings reforming Parts 32, 36, 61, 69, so as to complete the inquiry it initiated in CC Docket 94-145, because ILECs may still offer video services on a common carrier basis. While ILECs have expressed frustration with the Title II tariffing process for video services, it is too early to determine if common carriage of video signals will be part of an ILEC's service portfolio in the future.

[6] Notice at para. 22.

[7] Notice at para. 24.

telephone customers from continuing to bear the risk of ILEC video ventures.

It is possible that an administratively simple approach may not be flexible enough to protect telephone ratepayers from unanticipated nonregulated services that share facilities with telephony services, as well as the development of unanticipated technologies. Fortunately, the Commission need not anticipate in the proceeding the impact of services and technologies not yet invented, since its continuing jurisdiction over these issues allows it to revisit its rules as necessary. For this reason, MCI proposes that the Commission immediately deal with the cost allocation and spare capacity problems presented by video distribution and programming services in a simple, straightforward fashion. The Commission may subsequently initiate further notices of proposed rulemakings as they are needed.

IV. Cost Pools and Allocation Methods

MCI supports the Commission's tentative conclusion that it should "prescribe specific cost pools and allocation factors in this proceeding for allocating video programming and other nonregulated service costs."[8] A major point of contention throughout the video dialtone proceedings was the ILEC practice of directly assigning most video loop investment to telephony, rather than attribute these investments to video costs or common costs. By explicitly designing cost pools, and then assigning investments and expenses to them, the Commission would establish clear guidelines as to which facilities were serving multiple services.

A. Direct Assignment

In its Notice, the Commission seeks comment on the "extent to which direct assignment can be used to allocate the costs of loop plant used for services subject to regulation under Title II

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[8] Id. at para. 27

and video programming and other competitive services, between regulated and nonregulated activities."[9] While direct assignment of loop, transport, and other network components may have yielded cost-causative results when most nonregulated services were not provided over the ILEC's networks, now that more and more nonregulated services are being offered over ILEC networks, often requiring new facilities which are subsequently also used by regulated services, direct assignment reflects cost causation to a much lesser degree.

Unless the Commission modifies its Part 32 accounts, or reinstate its subsidiary tracking requirements established for video dialtone costs, to explicitly identify the types of costs and investments required for video systems, it will not be possible to directly assign most video costs.[10] While the Commission should begin this task in order to be prepared for the possibility that some ILECs may offer video services on a common carrier basis, doing so will be a lengthy, complicated task. In the meantime, and to deal with the immediate likelihood that ILECs will offer video services over open video systems, the Commission will need to develop appropriate allocators for commonly used plant and plant-related expenses.

B. Allocation Methods

The Commission must adopt allocation methods that will remove nonregulated costs from regulated activities in order to protect telephone ratepayers. The Commission proposes four allocation methods for consideration: (1) allocations based on usage measurements, (2)

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9 Id. at para. 28.

10 See In the Matter of Reporting Requirements on Video Dialtone Costs and Jurisdictional Separations for Local Exchange Carriers Offering Video Dialtone Services, DA 95-1409, AAD No. 95-59, Order Inviting Comments, Released June 23, 1995.

allocations based on a ratio of directly assigned plant, (3) allocations based on a stand alone cost ceiling, and (4) allocations based on fixed factors. MCI recommends the Commission adopt option 3 -- allocations based on a stand alone cost ceiling because:

- it would be administratively simple;
- it would not require the Commission to establish specific cost pools;
- it would not require ILECs to submit detailed cost studies;
- it would establish consistency between "top down" allocated ILEC costs, and "bottoms up" incremental costs; and
- it would obviate the need to measure spare capacity and develop mechanisms to remove it from regulated accounts.

1. The Commission should establish an allocator based on stand alone costs

In its Notice, the Commission seeks comment on the reasonableness of establishing a "ceiling based on the cost of the current stand-alone telephone system, thus capping the amount of costs an incumbent local exchange carrier may assign to regulated activities.[11] The concept behind this approach has merit. By capping regulated costs at the stand alone cost of providing a telephone network, the Commission would insulate telephone customers from bearing the risks of nonregulated ventures the ILECs may pursue, whatever they may be.

Having determined stand alone telephone costs from some source, the Commission would have to remove all remaining ILEC costs from existing cost accounts. A fixed allocator is the logical method of accomplishing this task. The ratio of stand alone telephone costs to all costs identified in the Part 32 accounts would establish a gross allocator that would be applied to all

[11] Notice at para. 35.

Uniform System Of Accounts (USOA accounts). MCI recommends the Commission adopt the estimates of stand alone costs in the Hatfield model to compute the allocator.[12] According to the Hatfield model, stand alone costs of Tier One ILEC telephone networks is approximately $51 billion, and total Tier One regulated revenues are approximately $82 billion, resulting in a factor that would allocate 62 percent of each account to regulated activities (51/82), and 38 percent to nonregulated activities.[13]

This approach has a number of advantages. First, it would be administratively simple. It would not require the Commission to establish specific cost pools as discussed above, and would avoid the need for special studies to develop separate allocators for each cost pool. Second, it would not require ILECs to submit detailed cost studies. Thus, it would both hasten the day ILECs would be able to provide video services over their open video systems, and would establish reliable telephone costs, free of manipulation by the ILECs. Third, it would establish consistency between "top down" allocated ILEC costs, and the "bottoms up" incremental costs that many

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12 See MCI Comments, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Attachment 1, The Cost of Basic Network Elements: Theory, Modeling and Policy Implications, Prepared for MCI Telecommunications Corporation, Hatfield Associates, Inc., March 29, 1996.

13 See The Cost of Basic Network Elements: Theory, Modeling and Policy Implications, Prepared for MCI Telecommunications Corporation, Hatfield Associates, Inc., March 29, 1996, at 36. The Hatfield model estimates the stand alone cost of a telephone network to be approximately $36 billion, and does not include an estimate of an efficient amount of customer operations expense. The $51 billion referred to includes $15 billion in embedded customer operations expense. This figure is no doubt overstated, since some of this embedded customer operations expense is wasteful, and some is also incurred for non-telephony services. Hence the 62 percent allocator is a conservative estimate of embedded costs that should be allocated to regulated purposes.

parties are advocating that the Commission implement for unbundled network elements. Finally, it would obviate the need to measure spare capacity and develop mechanisms to remove it from regulated accounts, since the Hatfield estimates of the cost of providing telephone service are based on a model of telephone service which has an economically efficient amount of "excess capacity," and no more.

2. The Commission should consider allocating common costs based on fixed factors in the event it does not adopt an allocator based on a stand alone cap.

MCI also supports allocation based on fixed factors, because:

- it recognizes the nontraffic sensitive nature of loop (and transport) facilities,
- its implementation would impose a minimum amount of administrative cost on ILECs and the Commission, and
- a fixed allocator can be selected that is consistent with cost causation principles, thereby protecting ratepayers.

In its Notice the Commission tentatively concludes that it "should prescribe a fixed factor for allocating loop common costs between regulated and nonregulated activities."[14] MCI supports the use of a fixed factor for allocating all nontraffic sensitive common costs.[15] MCI supports the Commission's tentative conclusion that the fixed allocation method considered appropriate for loop will also apply to transport The same factor should be applied to nontraffic sensitive switching costs as well. MCI contends that a certain aspects of switching is not traffic sensitive. Current switching costs are a function of line connections, trunk connections, and busy hour demand on the switch matrix and processor. Line connections are not traffic sensitive.

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14 Notice at para. 40.

15 Note: the previous method is also a fixed allocator approach.

Trunk connections are traffic sensitive. Busy hour costs reflect the relative use of the switch matrix and processor for both line and trunk connections. Vertical switch features are not incurred on a usage basis, and are not traffic sensitive. Consequently, it is appropriate to apply the fixed allocator to switching costs.

In its Notice, the Commission requests parties to comment on how to derive a specific fixed factor for allocating common costs. MCI recommends the Commission adopt a method to calculate its fixed allocation factor that allows regulated and nonregulated services to share the economies of scope that is possible when multiple services share common facilities. A reasonable approach would allocate common costs in proportion to regulated and nonregulated services relative stand alone costs. To illustrate: suppose the stand alone costs of a telephone network was $1,000, the stand alone cost of a video network was $800, and the cost of an integrated telephone/video network, where all facilities were used in-common, was $1,500. The sum of the stand alone costs of the separate networks is $1,800, so there are $300 savings that result from offering the services over an integrated network. The cost of a stand alone telephone network as a share of the stand alone costs of both networks is 55 percent (1000/1800). Consequently, an equitable sharing of the $300 economies of scope would allocate $165 to telephone services (.55 x 300), and $135 to video (.45 x 300). Thus, on an integrated basis telephony would be allocated $835, and video would allocated $665 of the common integrated network.

Stand alone cost estimates of telephone and video networks may be obtained from Johnson and Reed.[16] Johnson and Reed estimate the forward looking cost of a stand alone

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[16] See Residential Broadband Services by Telephone Companies? Technology, Economics, and Public Policy. Leland L. Johnson, David P. Reed. Rand Corporation, Santa Monica, Ca., 1990.

telephone network using digital loop carrier to be $568 and the stand alone cost of a residential fiber/coaxial cable hybrid network to be $659, yielding a sum of stand alone costs equal to $1,227. Using these figures, the allocator that would allocate 46 percent to telephony and 54 percent to video.[17] This estimate is supported by separate analyses of Pacific Bell's video dialtone application by Johnson and Mercer. Johnson found that 55 percent of the common costs of Pacific Bell's network should be allocated to video,[18] and Mercer estimated that more than 60 percent of the costs Pacific Bell's network costs should be allocated to its telephone customers.[19] MCI believes a reasonable fixed allocator would transfer between 55-60 percent of common costs to nonregulated activities.

3. Allocations based on usage measurements

In its Notice, the Commission tentatively concludes that allocations of common loop costs based on relative bandwidth and relative usage would not yield allocations consistent with economic principles of cost-causation.[20] The Commission argues that although video services require greater bandwidth and time of circuit use than telephone services, telephone services may

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17 This fixed allocator has a higher percentage allocated to video than the allocator based on a stand alone ceiling discussed above. That is because this allocator would only be applied to common costs, while the previous allocator would be applied to all USOA accounts.

18 Comments of California Cable Television Association, Re: Pacific Bell's December 7, 1994, December 16, 1994, December 22, 1994 Responses to the Commission's Second and Third Data Requests of November 21, 1994, December 9, 1994, File Nos. W-P-C 6913, 6914, 6915, 6916, Applications of Pacific Bell for Authority Under Section 214(a) of the Communications Act to Construct video Dialtone Facilities, Reply Declaration of Leland Johnson at 23.

19 Id., Declaration of Robert Mercer, at 9

20 Notice at para. 33.

require more circuits near the end-office and may impose greater traffic sensitive costs due to more frequent circuit splitting than is the case with video services. The Commission subsequently rejects usage based allocators of common loop costs.

Although MCI agrees with the Commission that adopting "usage-based methods would require the allocation of non-traffic sensitive costs on a traffic sensitive basis,"[21] MCI does not believe that such allocations would necessarily depart from economically rational cost allocations. MCI has, in the past, proposed that allocations of costs between video and telephone services should be based on a combination of relative bandwidth and relative usage, because it would account for the fact that much of the cost of redesigning and modernizing the ILEC's networks has been driven by their planned entry into video services.[22] Allocation methods based on forward looking cost models are best able to account for the costs of network redesign caused by the introduction of new services. Now that the Commission is seriously considering incorporating forward looking cost models into its interconnection rules, it is not necessary to rely on this combination of usage- and capacity-based allocation to account for the network redesign costs imposed by new services.[23]

4. The Commission should not develop allocation factors based on a ratio of directly assigned plant

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21 Notice at para. 30.

22 In the Matter of Bell Atlantic Telephone Companies Rates, Terms, and Regulations for Video Dialtone service in Dover Township, New Jersey, Transmittal Nos. 741, 786, Revision to Tariff F.C.C. No. 10, CC Docket No. 95-145, November 30, 1996.

23 See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Paras. 126-143.

In its Notice, the Commission seeks comment whether it would be appropriate to allocate common costs using proportion of investments that have been directly assigned to regulated and nonregulated activities.[24] Adopting this proposal would reproduce the inequities and conflicts that have plagued video dialtone to date. A major point of contention has been that the ILECs have been upgrading their networks with the intent of offering video and other nonregulated services, but not installing the features that identify these investments as being intended for nonregulated purposes until very close to the time they are ready to begin offering nonregulated services. This minimizes the amount of plant that would be directly assigned to nonregulated purposes. Using an allocator based on direct assignment would perpetuate this problem. Not only would this pattern of investment produce an inefficient allocation of costs, it would also promote a pattern of investment that is not economically efficient.

V. Commission Has Ample Authority To Adopt MCI's Suggested Resolution

There is a clear public interest reason for the Commission to adopt MCI's proposed allocation method. Unless the Commission removes nonregulated costs from regulated accounts, telephone ratepayers will be forced to subsidize ILEC ventures into an ever-increasing array new, nonregulated lines of business. In the case of interexchange carriers, they would be forced to continue subsidizing ILEC entry into their own businesses. The Commission also runs a risk of over-promoting the entry of ILECs into the video business if it permits ILECs to move ahead with OVS applications in the absence of immediate Part 64 reform; or it runs the risk of delaying legitimate ILEC provision of OVS services if it engages in a series of rulemakings designed to establish complicated cost allocation mechanisms. The Commission also has a sufficient amount

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[24] Notice at para. 34.

of independent and reliable data on the stand alone and incremental costs of video and telephone networks it may draw upon to determine a fixed allocation factor, which in turn will help ensure just and reasonable rates for both of these service categories. In short, there is a clear public interest, consistent with the Commission's mandate and expertise, justifying the adoption of a fixed allocation factor.

The Commission also requests parties to address the legal authority the Commission has to adopt a fixed allocation factor. A fixed allocator is a "rough justice" approach to ensuring that telephone ratepayers do not bear the burden of ILEC entry into video markets. This is a reasonable approach since cost allocation generally is a blunt instrument used to ensure that rates are within a range of reasonableness. Surgical precision is not attainable.[25] In this respect, a fixed allocator is no less reasonable provided there is some record of evidence to support it.[26]

In addition, Sections 651-3 of the 1996 Act are intended to create a competitive market for video services by placing telephone companies in a position to compete with the existing cable industry.[27] Competition will only be effective to the extent that competitors have an opportunity to compete on their ability to provide efficient, high quality video serivces. It cannot work if regulation introduces distortions in one competotor's underlying cost, as would occur if telephone ratepayers subsidized ILEC entry into video markets. A flat allocator, which will provide a

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[25] See In the Matter of separation of costs of regulated telephone services from costs of nonregulated activities, CC Docket No. 86-111, Report and Order, 2 FCC Rcd 1298 (1987) at 1313.

[26] See In the Matter of Exchange Network Facilities (ENFIA), 71 FCC 2d 440 (1979), Memorandum Opinion and Order.

[27] See Section 653(b)(1)(A) which requires the Commission to implement rules ensuring that rates for carriage on open video systems are just and reasonable.

foundation for a competitive video market, is fully consistent with the 1996 Act.

Finally, the Commission's legal authority to adopt a flat allocator draws from its 4(i) powers.[28] This authority has been used, and upheld by the courts, in analogous cases to resolve allocations of joint and common costs.[29]

VI. Spare Facilities

In its Notice, the Commission seeks comment on how spare facility costs should be allocated between regulated and nonregulated activities. Currently, the Commission's rules allocate spare capacity on the basis of relative regulated and nonregulated usage projected over a three-year planning period.[30] Thus, ILECs have been able to invest in new facilities in preparation of entering new lines of business such as video and interexchange services without having to allocate any excess facilities costs to these nonregulated services, since they have not, as yet, entered these lines of business. In the meantime, telephone customers have been funding the deployment and depreciation of these facilities.

The magnitude of spare facilities intended for nonregulated purposes, which are being funded by regulated telephone customers is quite large. The Commission points out that "[d]uring 1991, 1992, 1993, and 1994, the LEC's total spare fiber, as a percent of total fiber deployment, was approximately 65 percent, 63 percent, 70 percent and 65 percent.[31] The

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28 47 U.S.C. Section 154(i).

29 See, Rural Telephone Coalition v. F.C.C., 838 F.2d 1037 (1988), and National Association of Regulatory Utility Commissioners v. F.C.C., 737 F. 2d 1095, 1111 (1984), *cert. denied*, 469 U.S. 1227 (1985).

30 47 C.F.R. Section 64.901(b)(4).

31 Notice at para. 52, note 60.

Hatfield model confirms the view that spare capacity is as large as utilized capacity. Hatfield estimates that the investment cost of providing a telephone network for all Tier One companies is approximately $131 billion, compared to total actual investment of $256 billion.[32] These facts are further support that between 50-70 percent of cable and wireless, central office transmission, and office network accounts should be removed from regulated activities.

MCI supports the Commission's view that Congress did not intend telephone exchange or access customers to recover the costs of spare capacity whose ultimate purpose it to provide nonregulated video and interexchange service. Now that the ILECs stand poised to enter the interexchange and video markets, it is imperative that the Commission immediately remove spare capacity from regulated accounts, and reimburse telephone customers for the amount of nonregulated spare capacity for which they have already paid.

The most administratively simple approach would be for the Commission to adopt our earlier recommendation of a cost allocation ceiling in Section B.1. above. This would involve establishing a gross allocator based on the ratio of stand alone telephone costs to total regulated revenues of the ILECs, and allocating this share of total USOA booked costs to regulated services. This approach would remove spare capacity because the estimate of stand alone costs provided by MCI assumes only an economically efficient amount of excess capacity. MCI recommends the Commission apply this factor which would allocate 62 percent of all USOA accounts to regulated purposes and 44 percent to nonregulated, as its method of resolving its treatment of spare capacity and common cost allocation. In the event the Commission does not adopt this approach, MCI recommends the Commission allocate 60 percent of cable and wireless,

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[32] Hatfield Model, March 29, 1996, at 36.

central office transmission, and office network accounts to nonregulated activities.

VII. The Impact of Part 64 Reform on Price Cap Regulation

In its Notice, the Commission seeks comment on whether its Part 61 rules governing price cap LECs require that "all such reallocations to nonregulated activities that may result from offering of video programming services or other nonregulated should trigger decreases in related price cap indices."[33] The Commission's price cap rules define exogenous cost changes, in part, as changes based on [t]he reallocation of investment from regulated to nonregulated activities pursuant to Section 64.901."[34]

Section 64.901(v) of the Commission's rules pertain to reallocations that would occur due to changes in the projected relative usage of common facilities by regulated and nonregulated services. Since the Commission may bring about a reallocation of costs by replacing the usage-based allocator described in Section 64.901(v) with a fixed allocator, it should issue a declaratory ruling that all reallocations resulting from this docket will be considered exogenous changes for price cap purposes. The Commission has already envisioned the need for such a ruling by including as exogenous costs changes, "...those cost changes that the Commission shall permit or require by rule, rule waiver, or declaratory ruling..."[35]

In its Notice, the Commission seeks comment on the "need for Part 64 processes in our regulation of price cap carriers that are not subject to sharing obligations."[36] Clearly, price cap

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33 Notice at para 60.

34 47 C.F.R. Section 61.45(d)(v).

35 47 C.F.R. Section 61.45(d).

36 Notice at para. 62.

companies that do not elect sharing will not be required to "...make such exogenous cost changes as may be necessary to reduce PCIs to give full effect to any sharing of base period earnings required by the sharing mechanism."[37] That does not mean that price cap companies that do not elect sharing are not required to implement other exogenous cost changes that apply to them. They too will have to lower their price cap indices, and lower their rates if rates are near the cap. These price reductions are the only mechanism by which telephone customers will be protected from any future subsidization of nonregulated ventures by ILECs.

VIII. Conclusion

For the above-mentioned reasons, MCI encourages the Commission to adopt the tentative conclusions that it proposes in the Notice, and to adopt the proposals suggested by MCI herein.

Respectfully submitted,
MCI TELECOMMUNICATIONS CORPORATION

Lawrence Fenster
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(202) 887-2180

May 31, 1996

[37] 47 C.F.R. Section 61.45(d)(2).

STATEMENT OF VERIFICATION

I have read the foregoing and, to the best of my knowledge, information and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on May 31, 1996.

Lawrence Fenster

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CERTIFICATE OF SERVICE

I, Stan Miller, do hereby certify that copies of the foregoing Comments were sent to the following on this 31st day of May, 1996.

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